Calendar No. 907

100TH CONGRESS
2d Session

SENATE

REPORT
100-485

AMENDING THE NATURAL GAS POLICY ACT OF 1978 TO REMOVE CERTAIN CONTRACT DURATION AND RIGHT OF FIRST REFUSAL REQUIREMENTS

AUGUST 11 (legislative day, AUGUST 10), 1988.—Ordered to be printed

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Mr. JOHNSTON, from the Committee on Energy and Natural Resources, submitted the following

REPORT

[To accompany H.R. 2701]

The Committee on Energy and Natural Resources, to which was referred the Act (H.R. 2701) to amend the Natural Gas Policy Act of 1978 to remove certain contract duration and right of first refusal requirements, having considered the same, reports favorably thereon without amendment and recommends that the Act do pass.

PURPOSE OF THE MEASURE

The purpose of H.R. 2701 is to repeal two non-price provisions in section 315 of the Natural Gas Policy Act of 1978 ("NGPA"). They are (1) section 315(a)(3) which requires contracts for purchase of "new" natural gas produced from certain Outer Continental Shelf leases to be for a duration of not less than 15 years, or, if less, the commercially producible life of the reservoir, and (2) section 315(b) which establishes a right to an offer of sale, and a right of first refusal, for existing purchasers of certain natural gas committed or dedicated to interstate commerce upon the expiration or termination of an existing contract. The Committee does not intend to affect or influence any court review of the validity of any FERC rule, regulation, opinion, or order issued prior to enactment of this legislation.

BACKGROUND AND NEED

Congress enacted the NGPA following a period of severe natural gas shortages in the interstate market. A basic goal of the complex

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legislation was to encourage production of additional supplies of natural gas by allowing gradual increases in the maximum lawful price allowed to be charged by producers of natural gas. The NGPA distinguished between so-called "old" and "new" natural gas. Broadly stated, new gas is gas produced from wells drilled after 1977 when the legislation was first proposed; old natural gas is gas produced from wells drilled prior to the time. The NGPA provided for eventual price deregulation of most new natural gas, while retaining price controls on old natural gas.

The legislation also sought to break down the distinctions between the interstate and intrastate markets for natural gas through a variety of mechanisms. The Federal Energy Regulatory Commission ("FERC") was given authority to authorize interstate pipelines to transport natural gas on behalf of any intrastate pipeline, and any local distribution company. FERC was also given authority to authorize intrastate pipelines to transport natural gas on behalf of any interstate pipeline, and any local distribution company served by any interstate pipeline, without affecting the status of any party to the transaction under the Natural Gas Act.

The NGPA also directly addressed concerns over security of natural gas supplies for interstate pipelines. Prior to the NGPA, large blocks of supplies had been "committed or dedicated" to the interstate market under the terms of the Natural Gas Act ("NGA"). However, new natural gas was no longer subject to regulation under the NGA. The Congress sought to insure that previously "committed or dedicated" supplies of natural gas under the NGA were still available to existing interstate pipeline purchasers of that gas, albeit at a higher price. It did so by enacting section 315 of the NGPA.

In the ten years since passage of the NGPA there have been fundamental changes in the operation of natural gas markets. The provisions in section 315 that were meant to assure interstate pipeline supplies are now encumbering the ability of producers, pipelines, and end users to enter into flexible contracts for the sale of natural gas. The provision is hampering both sellers and buyers in a much-changed natural gas marketplace.

In the years immediately following passage of the NGPA, pipelines pursued new gas supplies aggressively. They signed relatively inflexible contracts which have not proved to be sufficiently adaptable in a constantly changing market environment. This has contributed to the take-or-pay problem.

The FERC has issued very flexible rules with respect to the requirements imposed by section 315; it allows purchasers to waive the rights provided by section 315, including both the requirement that the seller must make a bona fide offer to continue the sale of certain natural gas, and the requirement that the seller must give the purchaser a right of first refusal to match an offer of purchase made by a third party purchaser (*See* FERC Order No. 95, and Order No. 95-A, *FERC Statutes & Regulations, Regulations Preambles* ¶30,179 (1980) and ¶30,690 (1986). FERC has also determined that very flexible quantity and price provisions are consistent with section 315. (*See Forest Oil Corporation,* 43 FERC ¶61,294 (1988)).

In spite of FERC's flexible rules, the statute imposes a burden on private parties to contracts for the sale of natural gas. The provi-

sions no longer serve a useful public policy purpose and should be repealed.

Legislative History

H.R. 2701 was introduced in the House of Representatives on June 17, 1987. It was reported from the Subcommittee on Energy and Power on March 8, 1988, and from the Committee on Energy and Commerce on June 10, 1988. It passed the House on June 13, 1988, by voice vote and was referred to the full Committee on June 14, 1988. No hearings have been held in either body.

Committee Recommendation and Tabulation of Votes

The Senate Committee on Energy and Natural Resources, in open business session on August 10, 1988, by voice vote of a quorum present recommends that the Senate pass H.R. 2701 as described herein.

The vote was a voice vote; Senator Metzenbaum wishes to be recorded as voting against the measure.

Cost and Budgetary Considerations

The following estimate of the cost of this measure has been provided by the Congressional Budget Office.

U.S. Congress,
Congressional Budget Office,
Washington, DC, August 10, 1988.

Hon. J. Bennett Johnston, Jr.,
Chairman, Committee on Energy and Natural Resources, U.S. Senate, Washington, DC

Dear Mr. Chairman: The Congressional Budget Office has reviewed H.R. 2701, an act to amend the Natural Gas Policy Act of 1978 to remove certain contract duration and right of first refusal requirements, as ordered reported by the Senate Committee on Energy and Natural Resources, August 10, 1988.

H.R. 2701 would repeal provisions in current law that affect sale contracts for certain types of natural gas from both onshore and offshore federal lands. These changes would not significantly affect natural gas production on federal lands or the amounts of royalties that the federal government would receive. Therefore, CBO estimates that enactment of H.R. 2701 would result in no significant costs or savings to the federal government and in no costs to state or local governments.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is James Hearn, who can be reached at 226-2860.

Sincerely,

James L. Blum,
Acting Director.

Regulatory Impact Evaluation

In compliance with paragraph 11(b) of Rule XXVI of the Standing Rules of the Senate, the Committee makes the following eval-

uation of the regulatory impact which would be incurred in carrying out H.R. 2701. The bill repeals two provisions of existing law. As such, it lessons the regulatory burden currently imposed on both natural gas producers and natural gas pipelines.

No personal information would be collected in administering the program. Therefore, there would be no impact of personal privacy.

Existing paperwork requirements, necessary to prove compliance with the provisions of the existing law that would be repealed, would be eliminated.

Executive Communications

The Committee did not request executive agency recommendations relating to H.R. 2701. However, in response to written questions submitted on May 14, 1987, by Rep. Philip Sharp, Chairman of the House Subcommittee on Energy and Power, the Honorable Martha O. Hesse, Chairman of the FERC, submitted the following on May 26, 1987:

> The provision in NGPA section 315(a)(3) that no contract for the purchase of new natural gas produced from the Outer Continental Shelf (OCS) shall be for a term of less than 15 years (or the producible life of the reservoir if less) would be removed from the Act by the bill you have enclosed. The Commission believes that removal of regulatory obstacles which impede the flexibility of producers and purchasers to enter into agreements that reflect changing market realities at the wellhead will be beneficial to all segments of the natural gas industry. Indeed, the Commission in Order No. 436–A, issued December 23, 1985, held that a contract providing for termination by mutual agreement within the 15 year term of the contract does not violate NGPA section 315(a)(3). The Commission stated that its policy on exactly what contract termination provisions do not violate NGPA section 315 would be developed on a case by case basis. The removal of NGPA section 315(a)(3) would increase flexibility in contracting for otherwise deregulated gas supplies in the OCS. Thus, producers and pipelines would be free to sign contracts for any term and to include any terms providing for mutual or even unilateral termination of the contract.
>
> The enclosed bill would also repeal NGPA section 315(b) which provides existing purchasers with certain rights upon expiration or termination of a contract covering certain categories of deregulated gas. Order Nos. 95 and 95–A established Part 277 of the Commission's regulations which require a first seller of gas sold under NGPA sections 102(c), 103(c), and 107(c)(1)–(4) to make a bona fide offer to the original purchaser for the continued sale of gas upon expiration or termination of the contract covering the gas. The existing purchaser may then accept or reject the offer. If the purchaser rejects the offer, the Commission's regulations require the first seller to extend to the original purchaser a right of first refusal before the seller may accept a third party's offer.

The requirement that sellers make a bona fide offer and then offer a right of first refusal to an existing purchaser prior to making sales of otherwise deregulated gas subject to an expired or terminated contract is cumbersome and unnecessary. Today's wellhead markets are workably competitive, permitting purchasers to acquire needed gas supplies at market prices. Removal of NGPA section 315(b) would benefit consumers by eliminating complicated regulatory impediments to the operation of this competitive segment of the natural gas industry.

The effect on interstate gas prices of adoption of the enclosed bill would be to make them more market responsive by increasing competition in a less regulated wellhead environment.

CHANGES IN EXISTING LAW

In compliance with paragraph 12 of Rule XXVI of the Standing Rules of the Senate, changes in existing law made by the Act, H.R. 2701, as ordered reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

NATURAL GAS POLICY ACT OF 1978

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the "Natural Gas Policy Act of 1978".

(b) TABLE OF CONTENTS.—

TABLE OF CONTENTS

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TITLE III—ADDITIONAL AUTHORITIES AND REQUIREMENTS

Subtitle A—Emergency Authorities

Sec. 301. Declaration of Emergency.
Sec. 302. Emergency purchase authority.
Sec. 303. Emergency allocation authority.
Sec. 304. Miscellaneous provisions.

Subtitle B—Other Authorities and Requirements

Sec. 311. Authorization of certain sales and transportation.
Sec. 312. Assignment of contractual rights to receive surplus natural gas.
Sec. 313. Effect of certain natural gas prices on indefinite price escalator clauses.
Sec. 314. Clauses prohibiting certain sales, transportation, and commingling.
Sec. 315. Contract duration; [right of first refusal;] filing of contracts and agreements.

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SEC. 315. CONTRACT DURATION; [RIGHT TO FIRST REFUSAL;] FILING OF CONTRACTS AND AGREEMENTS.

(a) CONTRACT DURATION.—

(1) GENERAL RULE.—The Commission may, by rule or order, specify the minimum duration of any contract (other than any existing contract) for the purchase of natural gas to which section 601(a)(1)(A) or (B) is applicable. In no case may the mini-

mum contract duration specified under this paragraph applicable to natural gas produced from any reservoir exceed 15 years or, if less, the commercially producible life of such reservoir. [The provisions of this paragraph shall not apply to contracts of natural gas subject to the requirements of paragraph (3).]

(2) NONDISCRIMINATORY APPLICATION.—

(A) IN GENERAL.—Except as provided in subparagraph (B), the Commission may not exercise the authority provided under paragraph (1) in a manner which—

(i) provides an advantage to interstate pipelines by diverting supplies of natural gas to interstate pipelines and thereby denying adequate supplies of natural gas to intrastate pipelines; or

(ii) otherwise discriminates between purchases by interstate pipelines and intrastate pipelines of natural gas.

(B) SPECIAL CIRCUMSTANCES.—The Commission may vary any requirement established under paragraph (1) with respect to any contract by an interstate pipeline or intrastate pipeline to the extent necessary to respond to special circumstances.

[(3) CONTRACTS FOR PURCHASE OF OCS NATURAL GAS.—The Commission shall prescribe a rule which shall require that any first sale contract (other than any existing contract) for the purchase of natural gas which is produced from any reservoir on the Outer Continental Shelf and which is new natural gas (as defined in section 102(b)) or high-cost natural gas (as defined in section 107(c) (1), (2), (3), or (4)) shall be for a duration of not less than 15 years or, if less, the commercially producible life of the reservoir.]

[(b) OFFERS; RIGHT OF FIRST REFUSAL.—

[(1) APPLICATION.—This subsection shall apply with respect to any natural gas which is committed or dedicated to interstate commerce on the day before the date of the enactment of this Act and which is—

[(A) high-cost natural gas (as defined in section 107(c) (1), (2), (3), or (4));

[(B) new natural gas (as defined in section 102(c)); or

[(C) natural gas produced from any new, onshore production well (as defined in section 103(c)).

This subsection shall not apply to any natural gas committed or dedicated to interstate commerce solely by reason of section 2(18)(A)(i).

[(2) OFFER OF SALE.—The Commission shall, by rule, require that if natural gas subject to the requirements of this subsection is produced on or after the first day of the first month beginning after the date of the enactment of this Act, a bona fide offer to sell such natural gas must be made to the person who, but for the provisions of section 601(a)(1)(B) (relating to deregulation), would have been entitled pursuant to the commitment or dedication of such natural gas to interstate commerce to receive such natural gas if such natural gas were sold (or any successor in interest to such person).

[(3) RIGHT OF FIRST REFUSAL.—The Commission shall, by rule, require that following—

[(A) the expiration or termination of any contract with respect to the first sale of natural gas subject to the requirements of this subsection to the person who, but for the provisions of section 601(a)(1)(B) (relating to deregulation), would have been entitled pursuant to the commitment or dedication of such natural gas to interstate commerce to receive such natural gas if such natural gas were sold (or any successor in interest to such person), or

[(B) any rejection of any bona fide offer, described in paragraph (2), to sell natural gas subject to the requirements of this subsection,

such person who would have been entitled to receive such natural gas shall be granted a right of first refusal of the first offer to sell such natural gas which, subject to the exercise of any right of first refusal under this paragraph, has been substantially accepted in principle by another person in an arms-length transaction.]

[(c)] *(b)* FILING OF CONTRACTS AND ANCILLARY AGREEMENTS.—The Commission may, by rule or order, require any first sale purchaser of natural gas under a new contract, a successor to an existing contract, or a rollover contract to file with the Commission a copy of such contract, together with all ancillary agreements and any existing contract applicable to such natural gas.

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